No. 91-913

In The

Supreme Court of the United States

October Term, 1991

JOHN R. PATTERSON,

Trustee, Petitioner,

v.

JOSEPH B. SHUMATE, JR.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF AND BRIEF OF AMICI CURIAE WAL-MART STORES, INC. AND WACHOVIA BANK AND TRUST, N.A. IN SUPPORT OF RESPONDENT

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Pursuant to Rule 37.4 of the Rules of the Court Amici Curiae, Wal-Mart Stores, Inc. (hereinafter "Wal-Mart") and Wachovia Bank and Trust, N.A. (hereinafter "Wachovia Bank"), move the Court for leave to file the attached amicus curiae brief, urging the Court to AFFIRM the United States Court of Appeals for the Fourth Circuit. Wal-Mart and Wachovia Bank received written consent from Respondent to file an amicus curiae brief but not from Petitioner, necessitating this motion.

Wal-Mart and Wachovia Bank are the appellants in Appeal No. 90-2957-WM, styled *William A. Wear, Trustee v.*

Wachovia Bank & Trust, N.A. and Wal-Mart Stores, Inc., now pending before the United States Court of Appeals for the Eighth Circuit (the "Wal-Mart Appeal"). In an order issued in the case of *Nelson v. Zenith Electronics Corporation*, Appeal No. 91-2585WM, a case presenting the same issues as the instant case and in the Wal-Mart Appeal, the Eighth Circuit ordered that that case be held in abeyance pending a decision by this Court in the instant case. Although a similar order has not been entered by the Eighth Circuit in the Wal-Mart Appeal, it is the understanding of counsel for Wal-Mart and Wachovia Bank that the Eighth Circuit will also hold the Wal-Mart Appeal in abeyance pending a decision by this Court.

The Wal-Mart Appeal was necessitated by a turnover complaint filed against Wal-Mart and Wachovia Bank by William A. Wear, bankruptcy trustee for debtors Howard C. Green and Verla B. Green, who had filed a petition for relief under 11 U.S.C. Chapter 7. Mr. Green was a participant in the Wal-Mart Stores, Inc. Profit Sharing Plan (the "Wal-Mart Plan"). The United States Bankruptcy Court for the Western District of Missouri, Southern Division, ordered a turnover of Mr. Green's accrued benefit in the Wal-Mart Plan to Mr. Wear. On appeal, the United States District Court for the Western District of Missouri affirmed, leading to the appeal by Wal-Mart and Wachovia Bank before the Eighth Circuit. Wal-Mart and Wachovia Bank have resisted a turnover of Mr. Green's accrued benefit to the bankruptcy trustee on several grounds, including the reason that a participant's accrued benefit in a qualified employee pension benefit plan is excluded from that participant's bankruptcy estate pursuant to 11 U.S.C. §541(c)(2), or, in the alternative, that a participant's accrued benefit in such a plan is exempt from that participant's bankruptcy estate pursuant to 11 U.S.C. §522(b)(2)(A).

Wal-Mart and Wachovia Bank's brief therefore supports Respondent on the above exclusion and exemption issues. This brief, however, raises other issues not set out in the parties' briefs. These additional issues are as follows:

1. A decision by this Court would have an impact on all qualified pension plans in the United States, whether they be those of an individual with substantial or complete control over the plan or the plan sponsor, as in the instant case, or those sponsored by large publicly-held corporations where plan participants have no control over the plan or distribution or withdrawal of their accrued benefit from the plan, as in the Wal-Mart Appeal;

2. The distribution of a debtor's accrued benefit in a qualified plan by order of a bankruptcy court which is not otherwise distributable to the participant under the terms of the plan will result in disqualification of the plan under §401(a)(13)(A) of the Internal Revenue Code of 1986, as amended ("I.R.C.") (26 U.S.C. §401(a)(13)(A)); and

3. A bankruptcy trustee acquires no greater rights than the debtor and, therefore, if the debtor cannot force a distribution under a qualified plan, neither can his bankruptcy trustee, even if the participant's accrued benefit is part of the bankruptcy estate and is non-exempt.

Wal-Mart and Wachovia Bank believe that several of the above issues may be raised by the parties in their briefs, but Wal-Mart and Wachovia Bank do not believe they will be fully explored, especially from the perspective of the risks to plans sponsored by major corporations. Secondly, Movants believe that it is imperative that the Court be appraised that an adverse decision in the instant case will affect not only small pension plans sponsored by professional corporations and closely-held corporations but also plans sponsored by large publicly-held corporations.

WHEREFORE, having shown an interest in the instant case and raising arguments including the concerns of large qualified plan sponsors, tax disqualification of qualified plans, and the powers of the bankruptcy trustee, AMICI CURIAE Wal-Mart and Wachovia Bank pray that this motion be GRANTED.

Respectfully submitted,

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BRIEF OF AMICI CURIAE WAL-MART STORES, INC. AND WACHOVIA BANK AND TRUST, N.A. URGING THE COURT TO AFFIRM ON BEHALF OF RESPONDENT

STATEMENT OF INTEREST OF WAL-MART STORES, INC. AND WACHOVIA BANK & TRUST, N.A., AS AMICI CURIAE

This brief is submitted on behalf of Wal-Mart Stores, Inc., a Delaware corporation ("Wal-Mart"), and Wachovia Bank & Trust, N.A. ("Wachovia Bank"), in support of the Respondent, Joseph B. Shumate, Jr. Wal-Mart and Wachovia Bank are the appellants in Appeal No. 90-2957, *William A. Wear, Trustee v. Wachovia Bank & Trust, N.A., and Wal-Mart Stores, Inc.*, now pending before the United States Court of Appeals for the Eighth Circuit.

On July 27, 1989, debtors Howard C. Green and Verla B. Green filed a petition for relief under 11 U.S.C. Chapter 7. A dispute arose in the proceeding concerning the status of Mr. Green's accrued benefit in the Wal-Mart Stores, Inc., Profit Sharing Plan (the "Wal-Mart Plan" or "Plan"). The bankruptcy trustee filed a turnover complaint under 11 U.S.C. §543 against debtors, Wal-Mart, and Wachovia Bank, seeking to withdraw Mr. Green's account balance from the Plan, which was resisted by Wal-Mart and Wachovia Bank. After adverse determinations by the United States Bankruptcy Court for the Western District of Missouri, Southern Division, and the United States District Court for the Western District of Missouri, Wal-Mart and Wachovia Bank appealed to the Eighth Circuit.

Wal-Mart established the Plan and the Wal-Mart Stores, Inc., Profit Sharing Trust (the "Trust") as part of the Plan in 1971. The Plan is qualified under §401(a) of the Internal Revenue Code of 1986, as amended (the "I.R.C.") and is subject to the Employee Retirement Income Security Act of 1974 ("ERISA"). Wachovia Bank is the currently acting trustee of the Trust.

Wal-Mart operates approximately 1,728 discount retail stores in 40 states, and approximately 212 additional stores in 37 states under the trade name "Sam's Wholesale Club". There are approximately 220,000 participants in the Wal-Mart Plan. As of January 31, 1991, Plan assets totaled $1.8 billion.

The Wal-Mart Plan is entirely funded by contributions from Wal-Mart. Annual contributions are made at the sole discretion of the Board of Directors of Wal-Mart. The Plan does not accept, nor require, any employee contributions.

At the time of the filing of the bankruptcy petition by Mr. and Mrs. Green, and throughout the Wal-Mart Appeal, Mr. Green was and is employed by Wal-Mart as a store manager. Mr. Green is not an officer or director of Wal-Mart or Wachovia Bank.

As required by I.R.C. §401(a)(13)(A) and 29 U.S.C. §1056(d)(1) (hereinafter §206(d)(1) of ERISA), the Wal-Mart Plan prohibits the alienation or assignment of a participant's accrued benefit in the Plan. The Plan allows for the distribution of a participant's accrued benefit only upon death, disability, retirement or termination of employment. Participant loans are not permitted.

Wal-Mart respectfully submits the above facts to show that while the legal issues in the instant case and in the Wal-Mart Appeal are similar, the factual situations in these cases are very different. Unlike Mr. Shumate, Mr. Green has no control whatsoever over the Wal-Mart Plan, Wal-Mart or Wachovia Bank. He is a middle manager in a large, publicly-held corporation. This company, and many others, have established retirement plans for the benefit of their employees designed to provide retirement income to those employees. These plans are not established as personal savings accounts for the employees, subject to withdrawal by the employee at his discretion.

Further, unlike the pension plan in the instant case, the Wal-Mart Plan has not been terminated, and Mr. Green is still employed by Wal-Mart. Thus, no event triggering a distribution of Mr. Green's accrued benefit under the terms of the Wal-Mart Plan has occurred. This presents an issue concerning the powers of a bankruptcy trustee which often arises in this area which is not being addressed by Petitioner and Respondent in the instant case.

Further, the instant case does not address the adverse income tax consequences which will result should a participant's accrued benefit in an active qualified retirement plan be turned over to a bankruptcy trustee for further distribution to the participant's unsecured creditors. In a series of private letter rulings (one of which was issued directly to Wal-Mart in connection with a prior bankruptcy proceeding), the Internal Revenue Service (the "Service") has taken the position that such a turnover would result in disqualification of the plan under I.R.C. §401(a)(13)(A). Disqualification of the Wal-Mart Plan would have severe adverse tax consequences to the participants and beneficiaries of the Wal-Mart Plan, as well as to Wal-Mart itself as the sponsor of the Plan.

The Court's decision in the instant case will in all likelihood not only be dispositive of the Wal-Mart Appeal, but would affect the retirement plans sponsored by other large companies. A determination by the Court that a bankruptcy trustee of a plan participant could reach that participant's accrued benefit to satisfy that participant's debts would eviscerate the very purpose such companies adopt such plans (and thwart the express Congressional intent of safeguarding a stream of retirement income to participants and their beneficiaries), and would expose such plans (and the plan sponsors) to severe adverse tax consequences. Wal-Mart and Wachovia Bank believe they have information relevant to these issues, and to this Court's consideration of the Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

SUMMARY OF ARGUMENT

I. 11 U.S.C. §541(a)(1) defines the bankruptcy estate to include all legal and equitable interests of the debtor in property as of the commencement of the case. However, 11 U.S.C. §541(c)(2) provides that a restriction on a transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a bankruptcy case.

Section 403(a) of ERISA (29 U.S.C. §1103) provides that the assets of an employee pension benefit plan must be maintained in a trust. ERISA §206(d)(1) provides that the pension plan must provide that the benefits provided under the plan may not be assigned or alienated. I.R.C. §401(a)(13)(A) requires, as a condition for tax qualification, that the plan of which the trust is a part must provide that benefits provided under the plan may not be assigned or alienated. Thus, transfers of a participant's beneficial interest in a trust maintained as a part of a qualified plan are restricted. That restriction is clearly enforceable under applicable nonbankruptcy law. Thus, that restriction on transfer is enforceable in a bankruptcy proceeding.

Section 541(c)(2) is unambiguous on its face, and resorting to its legislative history is unnecessary. Even if the legislative history of §541(c)(2) is reviewed, the results would be inconclusive. There is nothing in the statute, or in the Bankruptcy Code, to warrant limiting the phrase "applicable nonbankruptcy law" in §541(c)(2) to state law, much less to state spendthrift trust law. Finding that a participant's accrued benefit in a qualified plan is excludable from his bankruptcy estate harmonizes the provisions of the Bankruptcy Code, ERISA, and the

Internal Revenue Code on this issue. It prevents a creditor from circumventing ERISA §206(d)(1) by pushing a debtor into involuntary bankruptcy in order to reach his ERISA funds. It furthers ERISA's broader purpose of ensuring uniform treatment of pension benefits throughout the country.

II. Assuming, *arguendo,* that a participant's accrued benefit in a qualified plan is not excludable from the bankruptcy estate under 11 U.S.C. §541(c)(2), his accrued benefit in the plan would be exempt from his bankruptcy estate pursuant to 11 U.S.C. §522(b)(2)(A). Section 522(b)(2)(A) is also unambiguous on its face. It exempts from the bankruptcy estate any property that is exempt under federal law. Pension benefits under ERISA-qualified plans are exempt from judgment, garnishment, levy, execution, or other legal or equitable process. The purpose of ERISA §206(d)(1) is to safeguard retirement income for pensioners. It provides the same protection for retirement income from private pension plans as the prohibitions which are provided under federal law against garnishment of retirement benefits under the Social Security Act, the Railroad Retirement Act, the Civil Service Retirement Act, and the Veterans' Benefits Act.

III. Assuming that a participant's accrued benefit in a qualified plan is not excludable from his bankruptcy estate under 11 U.S.C. §541(c)(2), and is not exempt from his bankruptcy estate under 11 U.S.C. §522(b)(2)(A), any distribution from the plan must still be in accordance with the terms of the plan. The filing of a bankruptcy petition, in and of itself, does not accelerate a participant's right to benefits under the plan. A qualified plan normally provides that a participant's right to benefits is usually triggered by the participant's death, disability,

retirement, or termination of service. If none of these events have occurred at the time the participant files a bankruptcy proceeding, then the participant is not entitled to a distribution of his benefit as of the filing date, and the bankruptcy trustee's rights to a distribution can be no greater than the participant. There is no provision in the Bankruptcy Code which grants such broad powers to the bankruptcy trustee, and such powers should not be implied.

IV. A turnover of a participant's accrued benefit in a qualified plan, in violation of I.R.C. §401(a)(13)(A), will result in a disqualification of the plan. There is no exception under I.R.C. §401(a)(13)(A) for turnovers in bankruptcy proceedings.

The Internal Revenue Service has consistently held, in a series of private letter rulings, that a turnover of a participant's accrued benefit in a qualified plan, not in accordance with the terms of the plan, will result in disqualification of the plan under I.R.C. §401(a)(13)(A). Such a disqualification would result in adverse tax consequences not only to the sponsor of the plan, but also to all other participants and beneficiaries in the plan.

ARGUMENT

I. A PARTICIPANT'S ACCRUED BENEFIT IN A QUALIFIED EMPLOYEE PENSION BENEFIT PLAN NOT DISTRIBUTABLE TO THE PARTICIPANT UNDER THE TERMS OF THAT PLAN IS EXCLUDED FROM THAT PARTICIPANT'S BANKRUPTCY ESTATE PURSUANT TO 11 U.S.C. §541(c)(2) BECAUSE ERISA §206(d)(1) CONSTITUTES "APPLICABLE NONBANKRUPTCY LAW".

The issue in the instant case is whether the Respondent, Joseph B. Shumate, Jr.'s, accrued benefit in the

Coleman Furniture Company Pension Plan (the "CFC Plan") constitutes an asset of his bankruptcy estate. 11 U.S.C. §541(a)(1) defines the bankruptcy estate to include "all legal or equitable interests of the debtor in property as of the commencement of the case." However, there is an important exception to this general rule, found at 11 U.S.C. §541(c)(2), which provides the following:

> "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."

In determining whether §541(c)(2) applies to a trust in which a debtor has a beneficial interest, two things must be considered. First, is there a restriction on the transfer of that debtor's interest in the trust? Second, assuming there is such a transfer restriction, is the restriction enforceable under "applicable nonbankruptcy law"?

Mr. Shumate has a beneficial interest in the trust which is maintained as a part of the CFC Plan. Under ERISA, there are two basic types of plans an employer can establish for the benefit of his employees: (a) a "pension benefit plan", which provides for retirement income; and (b) a "welfare benefit plan", which provides for health, legal, vacation or training benefits. Both the CFC Plan and the Wal-Mart Plan come within the definition of a "pension benefit plan".

Further, both the Wal-Mart Plan and the CFC Plan are "qualified plans" as defined in I.R.C. §401. Title II of ERISA sets forth amendments to the Internal Revenue Code relating to pension benefit plans. A "qualified plan" under I.R.C. §401 means a pension benefit plan which meets certain requirements as set forth in that section, thereby granting significant tax benefits to the employer sponsoring the plan and the employees participating in

the plan. These tax benefits include (a) deductibility of contributions by the employer to the plan in the year of the contribution, (b) earnings on the trust fund formed as part of the plan are exempt from taxation, and (c) participants are taxed on benefits only upon distribution.

ERISA §206(d)(1) provides, with respect to all pension benefit plans, that:

> "(d)(1) Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated."

I.R.C. §401(a)(13)(A) (26 U.S.C. §401(a)(13)(A)) requires, as a condition for tax qualification, that:

> "A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under the plan may not be assigned or alienated."

These provisions are often referred to as the anti-assignment and anti-alienation rule (hereinafter "anti-alienation rule"). The purpose of the anti-alienation rule is "to safeguard a stream of income for pensioners (and their dependents . . .) . . . " *Guidry v. Sheet Metal Workers' National Pension Fund*, 493 U.S. 365, 376 (1990). In *Guidry*, this Court held that neither the garnishment provision of the Labor-Management Reporting and Disclosure Act, nor equitable principles like the constructive receipt doctrine, can override the anti-alienation rule. The Court noted that a specific statute, like ERISA §206(d)(1), will not be "controlled or nullified by a general one", *Id.* at 375.

A provision in a qualified plan required by the anti-alienation rule is a restriction on the transfer of a participant's interest in that plan. Moreover, this restriction is enforceable under nonbankruptcy law. It has not been

suggested that Mr. Shumate could have received a distribution of his account balance outside the express terms of the CFC Plan, or that Mr. Shumate's creditors could reach his account balance outside of bankruptcy. The issue is whether the anti-alienation rule constitutes, under 11 U.S.C. §541(c)(2), a "restriction . . . enforceable under applicable nonbankruptcy law."

Four circuits have taken the position that the ERISA anti-alienation rule is includable within the contemplation of "applicable nonbankruptcy law", resulting in exclusion of a participant's accrued benefit in a qualified plan from the bankruptcy estate under §541(c)(2). See, *Anderson v. Raine (In re Moore)*, 907 F.2d 1476 (4th Cir. 1990); *In re Lucas*, 924 F.2d 597 (6th Cir. 1991); *Velis v. Kardanis*, 949 F.2d 78 (3rd Cir. 1991); and *Gladwell v. Harline (In re Harline)*, 950 F.2d 669 (10th Cir. 1991). Alternatively, four circuits have reached the conclusion that the anti-alienation rule is not, independently, a "restriction . . . enforceable under applicable nonbankruptcy law" within the meaning of §541(c)(2), but have determined that the scope of §541(c)(2) is limited to spendthrift trusts under applicable state law, and that retirement plans must qualify as such in order for the participant's accrued benefit to be excludable from the bankruptcy estate under §541(c)(2). See, *Samore v. Graham (In re Graham)*, 726 F.2d 1268 (8th Cir. 1984) (dealing with a physician who was the sole shareholder of his professional corporation); *Goff v. Taylor (In re Goff)*, 706 F.2d 574 (5th Cir. 1983) (dealing with a self-employed retirement (Keogh) plan); *Daniel v. Security Bank (In re Daniel)*, 771 F.2d 1352 (9th Cir. 1985) (also dealing with a physician who was the sole shareholder of his professional corporation); and *Lichstahl v. Bankers Trust (In re Lichstahl)*, 750

F.2d 1488 (11th Cir. 1985) (also dealing with a physician who was the sole shareholder of his professional corporation). The Seventh Circuit also apparently follows this later line of cases (see *Matter of LeFeber*, 906 F.2d 330 (7th Cir. 1990)), but this is not entirely clear. See, *Morter v. Farm Credit Services*, 937 F.2d 354 (7th Cir. 1991) (rejecting *Goff's* conclusion that §541(c)(2) refers only to "traditional" spendthrift trusts, but not mentioning ERISA). Likewise, the Ninth Circuit appears to have had some second thoughts concerning its holding in *Daniel*. See, *In re Kincaid*, 917 F.2d 1162, 1166 (9th Cir. 1990) ("We recognize a certain incongruity in the notion that only ERISA's anti-alienation provisions offer protection until bankruptcy, and only state spendthrift provisions do so in bankruptcy.")

Wal-Mart and Wachovia Bank believe that the holdings by the Third, Fourth, Sixth and Tenth Circuits cited above are correct, and that §541(c)(2) should not be narrowly construed to encompass only "traditional" spendthrift trusts under applicable state law. The anti-alienation rule, which is a federal statute designed to restrict the transfer of a participant's accrued benefit in a pension benefit plan, is a "restriction . . . that is enforceable under applicable nonbankruptcy law" within the meaning of §541(c)(2).

In *In re Moore, supra*, as in the Wal-Mart Appeal, the bankruptcy trustee took the position that the term "applicable nonbankruptcy law" under §541(c)(2) should be read narrowly to refer only to plans with transfer restrictions enforceable under state spendthrift trust law. The Fourth Circuit rejected this "overly restrictive interpretation" of §541(c)(2), and held that the term "applicable

nonbankruptcy law" is not limited to state spendthrift trust law:

> "The trustee in bankruptcy's narrow interpretation of §541(c)(2) cannot be squared with the section's broad language. 'Applicable nonbankruptcy law' means precisely what it says: all laws, state and federal, under which a transfer restriction is enforceable. Nothing in the phrase 'applicable nonbankruptcy law' or in the remainder of §541(c)(2) supports that the phrase refers exclusively to state law, much less to state spendthrift trust law." *Moore* at 1477.

The court noted that the bankruptcy trustee's interpretation of "applicable nonbankruptcy law" was not consistent with other uses of the identical phrase throughout the Bankruptcy Code. When Congress intended to refer only to state law in the Bankruptcy Code, it did so explicitly. The court stated that an appeal to legislative history is inappropriate because the language of §541(c)(2) is clear, and legislative history is irrelevant to the interpretation of an unambiguous statute. *Id.* at 1479.

The court noted that several circuit courts have read the term "applicable nonbankruptcy law" in §541(c)(2) to refer only to state spendthrift trust law, but commented:

> "These decisions have, in the main, involved self-settled trusts in which the settlor is the beneficiary with the power to amend or to terminate the trust without penalty, whereas here the beneficiaries do not control the plan, cannot make unrestricted withdrawals from it, cannot borrow against it, and cannot amend it." *Moore* at 1478.

Having concluded that the term "applicable nonbankruptcy law" is not limited to transfer restrictions

enforceable under state spendthrift trust law, the court then concluded that ERISA §206(d)(1) does contain an enforceable transfer restriction that would bring that statute within the meaning of the term "applicable nonbankruptcy law" within the meaning of §541(c)(2). The overriding purpose of ERISA was to guarantee the security of employees' retirement income, and one of the primary means by which ERISA protects workers' pension benefits is through restrictions on the assignment and alienation of these benefits. The court notes at 1480:

> "[The bankruptcy trustee's] position would provide creditors with a means to circumvent this restriction on their access. We see no evidence that Congress intended to invite a creditor to push a debtor into involuntary bankruptcy in order to reach his ERISA funds."

The court stated that ERISA, the Bankruptcy Code, and the Internal Revenue Code can best be harmonized by reading "applicable nonbankruptcy law" under §541(c)(2) to include ERISA. This conclusion "furthers ERISA's broader purpose of ensuring uniform treatment of pension benefits throughout the country." *Id.* at 1480.

> "Our holding ensures that the security of employee retirement benefits will not depend upon the particularities of state spendthrift trust law. Were it otherwise, a state that did not recognize spendthrift trusts at all could nullify the anti-alienation provisions of ERISA – a result that is contrary to ERISA's general pre-emptive force. See, 29 U.S.C. §1144(a)." *Moore, supra,* at 1480.

This last point is especially relevant to plan sponsors such as Wal-Mart, whose operations extend across a number of states, and whose employees reside in a number of states. To support the Petitioner's position

regarding §541(c)(2) – that it refers only to traditional spendthrift trusts enforceable under state law – is to force upon ERISA-qualified plans the vagaries of individual state laws. Different participants in the same plan would find their accrued benefits treated completely differently in bankruptcy, depending upon their state of residence. This possible disparate treatment flies in the face of §514(a) of ERISA (29 U.S.C. §1144(a)). Further, a focus under §541(c)(2) on state spendthrift trust law will only continue the current multiplicity of suits and fervent litigation in this area.

The Third Circuit, in *Velis v. Kardanis, supra,* in addition to embracing the reasoning of the Fourth Circuit in *Moore, supra,* addressed the argument that if the term "applicable nonbankruptcy law" in §541(c)(2) includes both state and federal law, the exemption provisions of 11 U.S.C. §522(d)(10)(E) would be superfluous or meaningless. §522(d)(10)(E) provides an exemption for a debtor's right to receive –

> "(E) a payment under a stock bonus, pension, profit sharing, annuity, or similar plan . . . , unless . . . such plan . . . does not qualify under [I.R.C.] §401(a), 403(a), 403(b), 408, or 409 . . . "

It is clear from the plain language of §522(d)(10)(E) that it is dealing with distributions from a qualified plan, "which the debtor has a present and immediate right to receive." *Velis v. Kardanis,* 949 F.2d at 81. These are commonly referred to plans which are in "in pay" status, that is, a triggering event for distribution has occurred under the terms of the plan, and the participant (or his beneficiary) is receiving retirement, death or disability payments from the plan.

The importance of §206(d)(1) within the general scheme of ERISA has been underscored by this Court in

the recent decisions of *Mackey v. Lanier Collections Agency & Service,* 486 U.S. 825 (1988), and *Guidry,* cited earlier. In *Mackey,* this Court specifically noted that §206(d)(1) is applicable to ERISA *pension* benefit plans, not *welfare* benefit plans. The Court held that §206(d)(1) "bars the assignment or alienation of pension plan benefits." *Mackey* at 836. In *Guidry,* this Court decided that the trustee of a labor union pension plan, who admittedly had embezzled from a labor union, was still protected by ERISA §206(d)(1). The *Guidry* Court at 493 U.S. 365, 376:

> "Nor do we think it appropriate to approve any generalized equitable exception – either for employee malfeasance or for criminal misconduct – to ERISA's prohibition on the assignment or alienation of pension benefits. Section 206(d) reflects the considered Congressional policy choice, a decision to safeguard a stream of income for pensioners (and their dependents, who may be, and perhaps usually are, blameless), even if that decision prevents others from securing relief for the wrongs done them. If exceptions to this policy are to be made, it is for Congress to undertake that task."

A finding that a participant's accrued benefit in a qualified plan is excluded from the bankruptcy estate of the participant under §541(c)(2) will not lead to abuses by debtors. The Internal Revenue Code limits the amount which may be contributed to a participant's account each year so as to prevent excessive accumulations. See, I.R.C. §415. Distributions prior to attainment of age 59½ or the occurrence of another qualifying event are subject to a 10% penalty. See, I.R.C. §72(t). Self-employed individuals maintaining plans may not borrow from their plans without obtaining an individual exemption from the Department of Labor (ERISA §408(d)), and loans to participants

under corporate plans, if permitted under the plan document, are severely restricted. See, I.R.C. §72(t), ERISA §408(b)(1).

An examination of this issue is necessary in order to harmonize the conflict among the Bankruptcy Code, the Internal Revenue Code, and ERISA, as well as to provide a consistency with respect to qualified pension plans among the states. To adopt the Petitioner's position is to contend that §541(c)(2) doesn't really mean what it says, that is, several words should be added, such as "state law", and even "state spendthrift trust law", and that there is an "implied" exception to ERISA §206(d)(1) and I.R.C. §401(a)(13)(A) for a bankruptcy trustee under the Bankruptcy Code. Concluding that ERISA §206(d)(1) constitutes "applicable nonbankruptcy law" would also be consistent with *Mackey* and *Guidry*. It is inconsistent to find that an embezzler's account balance in a qualified plan cannot be reached by the victims of that embezzlement, as was the case in *Guidry*, but that Mr. Shumate's account balance, or Mr. Green's account balance in the Wal-Mart Plan, can be reached by their creditors, simply because they are in bankruptcy.

II. A PARTICIPANT'S ACCRUED BENEFIT IN A QUALIFIED EMPLOYEE PENSION BENEFIT PLAN NOT DISTRIBUTABLE TO THAT PARTICIPANT UNDER THE TERMS OF THAT PLAN IS EXEMPT FROM THAT PARTICIPANT'S BANKRUPTCY ESTATE PURSUANT TO 11 U.S.C. §522(b)(2)(A).

Assuming, *arguendo*, that Mr. Shumate's account balance in the CFC Plan is not excludable from the bankruptcy estate under 11 U.S.C. §541(c)(2), his accrued benefit in the Plan is exempt from his bankruptcy estate

pursuant to 11 U.S.C. §522(b)(2)(A), which exempts from the bankruptcy estate:

> "Any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition . . . "

The ERISA anti-alienation rule clearly provides a nonbankruptcy federal exemption for a participant's interest in a qualified plan before that interest is distributable to the participant under the terms of the plan. While the accrued benefit is in trust for the benefit of the participant (and his beneficiaries), it is not subject to attachment, garnishment, levy, or execution.

This issue was considered by the courts in *Goff* and *Graham, supra*. Both cases held that the anti-alienation rule did not constitute a §522(b)(2)(A) federal exemption in a bankruptcy proceeding, primarily on the basis that the anti-alienation rule was not included in an "illustrative list of property which might be exempted under federal laws" set forth in the House and Senate Reports concerning §522(b)(2)(A). While the court in *Graham*, at 1274, noted that this list "was not meant to be exclusive", the court found "the failure of Congress to include ERISA plan benefits probative of Congressional intent that ERISA was not a 'federal law' upon which a §522(b)(2)(A) exemption could be based." However, this conclusion in *Graham* should be closely scrutinized in view of this Court's decision in *Guidry, supra*.

In *Guidry*, this Court reaffirmed the inviolable nature of the anti-alienation rule. At 493 U.S. 365, 376, the Court holds:

> "As a general matter, courts should be loathe to announce equitable exceptions to legislative

requirements or prohibitions that are unqualified by the statutory text. The creation of such exceptions, in our view, would be especially problematic in the context of an anti-garnishment provision."

Further, it should be noted that this Court in *Guidry* equated the prohibition against garnishment provided by ERISA §206(d)(1) "with other statutory provisions designed to safeguard retirement income", citing the prohibition against garnishment of retirement benefits under the Social Security Act, the Railroad Retirement Act, the Civil Service Retirement Act, and the Veterans Benefits Act. These federal prohibitions on garnishment are cited in *Goff* and *Graham* as "illustrative" of federal non-bankruptcy exemptions which are encompassed by 11 U.S.C. §522(b)(2)(A). In *Guidry*, the Court afforded the same status to the ERISA anti-alienation rule, which is applicable to private pension funds, as is afforded to other federal statutes which prohibit the alienation of other forms of retirement benefits.

In *In re Felts*, 114 Bankr. 131 (Bankr. W.D.Tex. 1990), the court addressed the argument that the anti-alienation rule is not included in the "illustrative list" in the House and Senate Reports concerning §522(b)(2)(A), *Felts* at 133:

> "The fact that Congress chose to provide an illustrative list of other federal law in its reports on 11 U.S.C. §522(b)(2)(A) certainly does not limit that other federal law to only those statutes listed:
>
> '[I]t is a non-sequitur to say that the *failure* to *include* something on an *illustrative* list is probative of an intent to exclude it from that list.'
>
> *In re Komet*, 104 B.R. 799 (B.R. W.D.Tex. 1989)." (Emphasis by the court.)

In *In re Starkey*, 116 Bankr. 259 (Bankr. D.Colo. 1990), the court found that the anti-alienation rule was an exemption under federal law and could be claimed under 11 U.S.C. §522(b)(2)(A). The *Starkey* court reviewed the *Mackey* and *Guidry* decisions, and concluded at 265:

> "Considering the *dicta* in *Mackey*, the holding in *Guidry*, and the strong view expressed by the Supreme Court that, in its opinion, it was the intention of Congress to create a federal exemption from involuntary alienation of pension benefits by the adoption of 29 U.S.C. §1056(d)(2), this Court concludes that ERISA must be considered to be another federal exemption for the purposes of 11 U.S.C. §522(b)(2)(A). The conclusion reached by the Court is consistent with the legislative history and properly harmonizes other potentially conflicting results."

In summary, the reasoning in *Goff* and *Graham* that the anti-alienation rule does not create an exemption under federal law, for purposes of §522(b)(2)(A), should now be re-examined, in light of the holding in *Guidry*. All of the federal statutes cited in *Guidry*, including ERISA §206(d)(1), reflect a "considered Congressional policy choice" that retirement benefits to pensioners are to be "safeguarded", whether those benefits are derived from private pension funds, as in the instant case and in the Wal-Mart Appeal, or from the federal government. There is no valid policy reason why one form of pension benefit is to be favored over another form of pension benefit.

III. IF A PARTICIPANT'S ACCRUED BENEFIT IN A QUALIFIED EMPLOYEE PENSION BENEFIT PLAN IS NOT DISTRIBUTABLE TO THAT PARTICIPANT UNDER THE TERMS OF THAT PLAN, THAT PARTICIPANT'S BANKRUPTCY TRUSTEE CANNOT FORCE A DISTRIBUTION OF THAT ACCRUED BENEFIT TO HIM FOR THE BENEFIT OF THAT PARTICIPANT'S UNSECURED CREDITORS, IN THAT THE BANKRUPTCY TRUSTEE ACQUIRES NO GREATER RIGHTS IN THE PLAN THAN THE PARTICIPANT HIMSELF.

It is a fundamental tenet of bankruptcy law that a bankruptcy trustee takes property of the debtor subject to the same restrictions on the property as existed prior to the bankruptcy. If valid property transfer restrictions bind the debtor, then the property comes into the bankruptcy estate (and into the hands of the bankruptcy trustee), subject to the same restrictions. See, *In Re Schauer,* 835 F.2d 1222, 1225 (8th Cir. 1987). This principle has been applied a number of times in bankruptcy cases dealing with qualified retirement plans.

In *In re DeWeese,* 47 Bankr. 251 (Bankr. W.D. N.C. 1985), the court held that the debtor's account in a qualified plan was property of the estate under 11 U.S.C. §541. However, the court went on to hold at 255-256:

> "Although the court finds that the debtor's interest in the profit sharing plan to be property of the estate, it is a fundamental tenet of bankruptcy law that a bankruptcy trustee can acquire no greater rights in property than the debtor possessed. [citation] Here, the debtor had only a vested, undivided interest in a plan of ever changing values wherein distribution was delayed for an indefinite period of time (until retirement, death, etc.). The debtor had made no contributions to the Plan, as these were solely

> borne by his employer; and he had no rights to use or transfer his interest prior to the end of his association with this employer. The full extent of his interest was a right to share in a future distribution of company stock. This share has not yet been identified, nor has his interest been valued. *And this, and this alone, is the interest to which the trustee succeeds.* Therefore, the court concludes that the debtor's interest, as of the petition date, became property of the estate by operation of law, and that there is nothing further available for turnover." (Emphasis added)

In *In re Silldorf,* 96 Bankr. 859 (C.D.Ill. 1989), like *De Weese,* the court found that the interest of the debtors in the plan was property of the bankruptcy estate. The issue then became, "one of defining just what those interests" were. *Id.* at 866. The court held at 866:

> "If a debtor does not possess an asset or a present right to demand, merely filing a petition for bankruptcy cannot create it. The court agrees that the Trustee is only entitled to the property or assets which the Debtors could demand. . . . Accordingly, because the debtor in this case was not entitled to a distribution of any nature from the Plan at the time of filing the petition, the bankruptcy Trustee is not entitled to compel a turnover of the assets sought herein."

In *In re Loe,* 83 Bankr. 641 (Bankr. D. Minn. 1988), the court concluded, "that the trustee has no immediate right to the funds representing Debtor's interest in the Plan; nor does he have any right to assign or sell the estate's interest in the Plan." *Id.* at 646. The court went on to hold at 646:

> "A debtor's rights may not be expanded beyond what they were at the commencement of the case . . . accordingly, the trustee's interest in the

> pension plan must be limited to the same interest as the Debtors' interest. Since the Debtors have no right to present distribution . . . , neither does the trustee."

This issue is apparently not being addressed in the instant case for the reason that the CFC Plan has been terminated, and the accrued benefit of the participants are distributable to them pursuant to the terms of the Plan. However, if it is determined that the accrued benefit of a participant in a qualified plan is not excludable from his bankruptcy estate under 11 U.S.C. §541(c)(2), and is not exempt under 11 U.S.C. §522(b)(1)(A), then the issue should be addressed, since such a determination under §§541(c)(2) and 522(b)(1)(A) will invariably lead bankruptcy trustees to seek turnovers of the accrued benefit of plan participants totally contrary to the distribution and withdrawal provisions of the plans.

Distribution under a qualified plan is usually made after the occurrence of certain specified events, such as death, disability or termination of service of the participant. None of these events may have occurred as of the bankruptcy filing date, and it cannot be predicted as of that date as to when they might occur. As stated in *Kincaid, supra*, 917 F.2d at 1168, termination of employment is "like other random or unpurposive events which can affect the debtor." Simply because a participant is 100% vested in his account balance does not mean the participant has an immediate right to the distribution of that account balance. Further, what ultimately will be the *amount* of the distribution, when the account balance is distributable in accordance with the terms of the plan? In the case of the Wal-Mart plan, approximately 87% of the Plan's assets consist of common stock of Wal-Mart. This stock is publicly traded on the New York Stock Exchange

and the Pacific Stock Exchange, and as a result its value is ever changing. Lastly, because contributions to a plan may be totally discretionary with the plan sponsor (as in the case of a profit sharing or stock bonus plan), there is no assurance that any further contributions will be made. The plan's sponsor, in its discretion, could always simply discontinue the making of contributions to the plan, but not actually terminate the plan.

Concluding that a bankruptcy trustee's rights to a participant's account balance can be no greater than the participant himself does not necessarily mean that the account balance will never be available for the benefit of the participant's creditors. Presumably, at some time a distributable event under the plan will occur triggering a distribution of some amount to the participant. The interest of the bankruptcy trustee would then mature, and the funds would then be available for distribution to creditors. Admittedly, this may result in delay in the administration of the case. The bankruptcy trustee could decide either to abandon the participant's interest in the plan under 11 U.S.C. §554(b), on the basis that it is burdensome to the estate or that it is of inconsequential value and benefit to the estate, or the bankruptcy trustee could decide to keep the case open with the idea that a distributable event may occur in the near future (for example, the participant's employment is terminated), and the distribution will come into the bankruptcy estate at least to the extent it represents benefits accrued prior to bankruptcy.

There are no provisions in the Bankruptcy Code to support an immediate turnover of a participant's accrued benefit in a qualified plan to that participant's bankruptcy trustee, if that accrued benefit is not distributable to the participant under the terms of the plan at the time

of the filing of the bankruptcy petition. 11 U.S.C. §541(c)(1), which invalidates any restriction on the transfer of an interest of the debtor in property which is property of the bankruptcy estate, would not be sufficient, even if the court has concluded that a participant's account balance is property of the bankruptcy estate and is not exempt and, therefore, has determined that the restriction on alienation of the participant's account balance is not applicable. Even though a restriction on transfer is no longer applicable, the invalidation of this restriction does not transform a contingent right of the participant into an absolute right, and does not accelerate the unmatured and inchoate rights of a debtor in property at the time of the filing of the bankruptcy petition. That is an entirely separate issue. 11 U.S.C. §544, which provides that a trustee in bankruptcy is given the rights and powers of a judicial lien creditor of the debtor as of the commencement of the bankruptcy proceeding, is also not sufficient. There is absolutely no question that a mere judicial lien creditor of a participant in a qualified plan cannot attach a participant's account balance in the plan as of the commencement of the bankruptcy proceeding. Such an attachment is clearly prohibited by the anti-alienation rule.

Wal-Mart and Wachovia Bank urge the Court to address this issue in the instant case. The issue has not been adequately addressed by the cases which hold that a participant's accrued benefit in a qualified plan is not excludable from the bankruptcy estate under §541(c)(2) and is not exempt from the bankruptcy estate under §522(b)(1)(A).

IV. A TURNOVER TO A PARTICIPANT'S BANKRUPTCY TRUSTEE OF THAT PARTICIPANT'S ACCRUED BENEFIT IN A QUALIFIED EMPLOYEE PENSION BENEFIT PLAN NOT DISTRIBUTABLE TO THE PARTICIPANT UNDER THE TERMS OF THE PLAN WILL RESULT IN DISQUALIFICATION OF THE PLAN UNDER §401(a) OF THE INTERNAL REVENUE CODE OF 1986, AS AMENDED.

It has been suggested by bankruptcy trustees that the issue of tax disqualification as a result of a turnover of a participant's accrued benefit in violation of the terms of a qualified plan is a "red herring" in this area. This position is apparently based on a belief that such a turnover does not violate the anti-alienation rule, or that there is an implied amendment to the anti-alienation rule based on the subsequent enactment of the Bankruptcy Code.

In *Regan v. Ross*, 691 F.2d 81 (2nd Cir. 1982), the court had before it not a private pension plan governed by ERISA, but a state employee retirement plan governed by state law. The benefits payable to the debtors in that case were in "in pay" status, and the issue was whether the pension beneficiaries could require their pension systems to transfer a portion of their monthly benefits for distribution to creditors under Chapter 13 of the Bankruptcy Code. The *Regan* court noted at page 87, "that to the extent that Congress evidenced clear intent to include pension benefits in the property of a Chapter 13 estate – a matter which we believe is demonstrated above – it necessarily amended §401(a)(13) and applicable Treasury Regulations accordingly." *Regan* has been cited a number

of times for the proposition that a turnover of a participant's accrued benefit will not result in disqualification of the plan under I.R.C. §401(a).

However, the reasoning in *Regan* concerning the anti-alienation rule is clearly inconsistent with this Court's holding in *Guidry*, i.e., if exceptions to ERISA §206(d) are to be made, "it is for Congress to undertake that task." *Guidry* at 493 U.S. 365, 376. *Guidry* places the "implied amendment" rationale of *Regan* in serious doubt. On the other hand, the position of the Service on this issue has been crystal clear. In reviewing the series of private letter rulings which the Service have issued with respect to this matter, it is obvious that the Service does not recognize any judicial exception to I.R.C. §401(a)(13)(A) with respect to bankruptcy. See, Ltr. Rul. 9011037 (December 20, 1989), Ltr. Rul. 8910035 (no date given), Ltr. Rul. 8829009 (May 6, 1988), and Ltr. Rul. 8[illegible]0 (May 5, 1981). Of course, pursuant to I.R.C. §6110(j)[illegible] private letter rulings may not be used as precedent. The purpose of I.R.C. §6110(j)(2), however, is to prevent taxpayers from relying on private letter rulings issued to other taxpayers in their transactions or tax cases. Wal-Mart and Wachovia Bank are not seeking to rely on these private letter rulings issued by the Service with respect to the qualification of the Wal-Mart Plan, however, but wish to point out that the position of the Service as consistently expressed in these rulings cannot be ignored. These rulings are also consistent with the reasoning in *Guidry*, that is, if exceptions to ERISA §206(d)(1) are to be made these exceptions must be explicit in the federal legislation itself, not implied or judicially created.

Further, a private letter ruling has been issued by the Service to Wal-Mart and Wachovia Bank directly on this

issue. On December 4, 1987, Michael A. Parker, another participant in the Wal-Mart Plan, and his wife filed a petition in the United States Bankruptcy Court for the Western District of Missouri, Southern Division, seeking relief under 11 U.S.C. Chapter 7. A dispute arose between Wal-Mart and the bankruptcy trustee with respect to that proceeding, concerning a turnover of Mr. Parker's account balance in the Wal-Mart Plan to the bankruptcy trustee. As a part of the settlement, Wal-Mart submitted to the Service a ruling request, concerning whether a distribution from the Plan of a portion of Mr. Parker's vested account balance to the bankruptcy trustee would result in a disqualification of the Plan under I.R.C. §401(a)(13)(A). On September 28, 1989, the Service issued its ruling, concluding that a turnover of Mr. Parker's accrued benefit in the Plan to the bankruptcy trustee, pursuant to the filing of a turnover complaint by the bankruptcy trustee and a turnover order issued by the court pursuant thereto, would result in disqualification of the Plan under I.R.C. §401(a)(13)(A).

The Service has, therefore, directly addressed this issue with respect to the Wal-Mart Plan. This ruling was issued by the Service as Ltr. Rul. 8951067, dated September 28, 1989. It unequivocally states that a turnover in circumstances as the instant case or the Wal-Mart Appeal will result in disqualification of the plan under I.R.C. §401. While bearing in mind the admonition under I.R.C. §6110(j)(3), we ask the Court to note that Ltr. Rul. 8951067 was issued by the Service directly to Wal-Mart with respect to the Wal-Mart Plan. The position of the Service taken in the Ltr. Rul. 8951067 is entirely consistent with the Service's position in the other private letter rulings cited earlier.

Wal-Mart now employs over 374,000 persons on either a full-time or part-time basis. As of January 1, 1991, there were approximately 220,000 participants in the Wal-Mart Plan. Disqualification of such a plan would have severe adverse consequences to the plan participants and beneficiaries, as well as to the sponsoring employer. Plan earnings would no longer be tax exempt, plan contributions will no longer be tax deductible, and it is reasonable to believe that the benefits of plan participants who are not parties to the bankruptcy case would be significantly affected.

The prospect of disqualification is a serious issue, and should be addressed accordingly. It cannot be dismissed on an assumption that such a drastic result would never follow the turnover of a single participant's account balance. As stated in *Moore* at 1480:

> "Furthermore, our holding avoids *the spectre of a bankruptcy trustee disqualifying an entire plan from tax exempt status by seeking turnover of a single bankrupt's interest in the plan*. Under the trustee's interpretation, ERISA does not withhold the debtor's interest in an ERISA-qualified profit sharing and pension plan from the bankruptcy estate. However, *a plan's ERISA-qualification and tax exempt status depend on compliance with [the anti-alienation rule]. If §541(c)(2) does not recognize ERISA as 'applicable nonbankruptcy law' that operates to exclude pension interests from the bankrupt's estate, then the plan's anti-alienation provisions will be violated and the plan may be subject to disqualification and loss of tax exempt status. [Citation] We do not think Congress intended such a result*." (Emphasis added)

In summary, allowing a turnover of a participant's account balance to that participant's bankruptcy trustee

before the participant's account balance would be distributable to him under the terms of the plan would necessitate the carving out of a judicial exception to ERISA §206(d)(1) with respect to bankruptcy proceedings. Such judicial exceptions are not recognized under I.R.C. §401(a)(13)(A) and, therefore, would result in disqualification of the plan. Such a result would be inequitable not only with respect to the plan sponsor, but also to the other plan participants and beneficiaries. To adopt the Petitioner's position is to leave qualified plans caught between the clashing rocks of Scylla – to turn over a participant's accrued benefit or face the possibility of contempt – and Charybdis – the risk of plan disqualification for obeying a court order. It clearly was not the intent of Congress to force plan sponsors and administrators to make such a Draconian choice.

CONCLUSION

For the foregoing reasons, and those stated in the brief of Respondent, Wal-Mart and Wachovia Bank respectfully request that this Court affirm the Court of Appeals for the Fourth Circuit, and find that Mr. Shumate's accrued benefit in the CFC Plan is excludable from his bankruptcy estate under 11 U.S.C. §541(c)(2), or, alternatively, that this accrued benefit is exempt from his bankruptcy estate under 11 U.S.C. §522(b)(2)(A). Further, should the Court determine that Mr. Shumate's accrued benefit is includable in his bankruptcy estate, and is not so exempt, Wal-Mart and Wachovia Bank request the Court to address the issues of a bankruptcy trustee's

power to force a distribution from a qualified plan contrary to its terms, and the tax consequences to the plan and the plan sponsor on such a distribution.

Respectfully submitted,

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